
SPECIAL DISTRICTS: A BRIEF REVIEW FOR PROSPECTIVE HOMEOWNERS



SPECIAL DISTRICT ASSISTANCE

Department of Local Affairs
1313 Sherman Street, Room 521
Denver, Colorado 80203
303-866-2156
www.dola.colorado.gov

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INTRODUCTION

Prospective residential property owners may have questions about special districts because of disclosure statements about "special taxing districts" which appear on various documents related to the sale and purchase of residential real property. This brief review provides information about the purposes, taxing authority and financial status of special districts to prospective residential property owners. **This document is not to be construed, in any way, as legal advice about special districts, in general, or about any specific district.**

Special Districts in Colorado are local governments, i.e., political subdivisions of the state, which make up a third level of government in the United States. (The federal and state governments are the other two levels.) Local governments include counties, municipalities (cities and towns), school districts, and other types of government entities such as "authorities" and "special districts."

Colorado law limits the types of services that county governments can provide to residents. Districts are created to fill the gaps that may exist in the services counties provide and the services the residents may desire. The majority of districts draw their boundaries in unincorporated county land, but residents of a municipality may be included in one or more districts.

There are many types of special districts in Colorado. Districts organized under Title 32, Article 1 of the state statutes provide ambulance, fire protection, water, sanitary sewer, health, and park and recreation services. In addition to these single-purpose districts are metropolitan districts, which can provide multiple services, including those provided by single-purpose districts, except health services, as well as street construction and improvements, mosquito control, television relay and translation, transportation, and traffic-related safety enhancements.

There are about 1,607 Title 32, Article 1 special districts in Colorado that provide the aforementioned services. These are the types of districts that will be discussed in this paper; we will not be addressing the many other kinds of special districts and authorities created for such things as water conservancy, housing, airports, groundwater management, soil conservation, etc.

Title 32, Article 1 special districts have various financial powers, including, but not limited to, the powers to tax and/or assess fees for services, and to issue municipal bonds to help pay for community improvements. At the same time, special districts must be publicly accountable, which means, among other things, they must hold open meetings, properly notice all meetings, keep minutes and other records, which are open for inspection by any citizen, hold elections for its governing board of directors, adopt annual budgets, and submit to annual financial audits.

For more information or for more DOLA technical assistance publications see the department's web site at www.dola.state.co.us, and, under Department Services, click on Information and Publications, Local Government Services Publications, and Special Districts.

SPECIAL DISTRICT FINANCING

As mentioned earlier, special districts have the authority to issue municipal bonds to help finance community improvements. Issuing bonds is a method of borrowing money, which places the district in legal indebtedness. This debt can only be issued as the result of an election. The bonds are sold to investors who must be repaid over time with interest. The repayment period on these bonds is usually twenty years. The district's annual payment on the debt is called "debt service." The investors' money is then used by the district to pay for necessary infrastructure such as streets, sidewalks, water treatment plants and lines, sewer treatment plants and lines, fire stations and trucks, recreation centers, golf courses, etc.

When bonds are sold to investors, the district makes a pledge to pay back the borrowed money at an agreed upon interest rate. The special district has legal authority to establish and collect property tax on the properties within its boundaries to redeem the bonds.¹ If the district has other revenues available to make the payments it may use those instead of, or as a supplement to, the property tax.

The tax levy is the rate of tax applied to the assessed value² of all the property within the district's boundaries. The levy generates tax revenue that the district will use to pay for providing the various services to its residents and to pay the debt service. The formula is:

$$\text{Mill Levy} \times \text{Assessed Value} = \text{Tax Dollars}$$

¹ **Municipal bonds** that are secured by the district's authority to levy property taxes are called "general obligation" municipal bonds. In the event of default, holders of general obligation bonds have the right to compel, through mandamus or by injunction, a tax levy to satisfy the issuer's obligation on the defaulted bonds. In this paper, any mention of municipal bonds refers general obligation municipal bonds, unless otherwise indicated.

² **Assessed value** is that portion of the total market value of property that can be assessed for property taxes. In Colorado, 7.96% of residential market value can be assessed for property taxes. The assessed value of a \$200,000 home, for example, would be 7.96% of \$200,000, which is \$15,920.

For example, if the total assessed value of property in a special district were \$10,000,000, and the district's tax levy were 25.000 mills, then the district would collect \$250,000 in annual property tax revenue.

$$(25.000 \text{ mills}/1,000) \times \$10,000,000 = \$250,000$$

Special district mill levies are seldom static. Decline in a district's assessed value, for instance, would also lead to a decline in property tax revenue, if the mill levy stayed the same from year to year. In this case, the district may seek a mill levy increase in order to preserve its revenue. Districts may also seek a mill levy increase to finance capital projects, but, after the project is completed, they may lower the mill levy to previous levels. Under Colorado's TABOR amendment (Article X, Section 20, Colorado Constitution), some mill levy increases may require voter authorization.

Metropolitan districts, since they can offer multiple services, are often established by developers to finance, through the issuance of municipal bonds, the infrastructure necessary to support a new subdivision. Streets, water and sewer lines, and other utilities, for example, must be provided to an area, which, prior to the subdivision's development, was vacant land. After the infrastructure is in place, the developer plans on new homes and businesses being built in the district. New and ongoing development increases the district's assessed value, and provides the tax base necessary to generate the revenue required to make payments on its outstanding municipal bonds. If development within a new district occurs as planned by the developer, mill levies can be kept fairly low and still generate tax revenue sufficient to meet the bond payments. Unfortunately, this does not always come to pass.

In the mid to late 1980's and early 1990's, approximately one dozen of the 875 special districts that were in existence at the time defaulted (e.g., failed to pay) on their municipal bond payments. The primary reason for the defaults was that development within the districts did not occur at the rates expected by developers. Consequently, the tax bases within these districts were insufficient, at the established mill levies, for generating tax revenue necessary to meet their municipal bond payments. In situations such as these, in which development does not occur within expected time frames, the mill levies within the districts must be increased, meaning higher tax bills for property owners within the districts.

Example:

- A district's build-out (i.e., maximum growth) is planned at 2,000 homes. The infrastructure has been built and financed with municipal bonds.
- Build-out is planned to occur in ten years, needing an average of 200 homes built per year.
- The district's annual payments on the municipal bonds are \$796,000.

- If the development were built out with 2,000 homes, each with an average market value of \$200,000 and an average assessed value of \$15,920, then the total assessed value of the district would be \$31,840,000. (Assessed value for residential property equals 7.96% of the market value of the property.)
- The district's mill levy for debt is set at 25.000 mills, which, at build-out, would yield property tax revenue in the amount of \$796,000, sufficient to pay the annual debt service on the bonds.
- At 25.000 mills, the average annual taxes owed to the district would be roughly \$398 per home.

HOWEVER,

- The real estate economy is slumping, and, as a result, only 1,000 homes have been built in the district after ten years.
- The market value and assessed value of each home are still \$200,000 and \$15,920, respectively, but, with only 1,000 homes built, the total assessed value in the district is \$15,920,000.
- The district's mill levy is set at 25.000 mills, but, at 50% of expected build-out, it is generating only \$398,000, which will cover only half of the annual debt service payment due on the outstanding municipal bonds.
- If the district does not have alternative sources of revenue, and it wishes avoid defaulting on its bond payments, it will have to raise its mill levy for debt to 50.000 mills in order to generate enough revenue to cover the \$796,000 bond payment.
- At 50.000 mills, the average annual taxes owed to the district would be approximately \$796 per home.

Some developers use their own resources to finance the cost of needed infrastructure, or they may borrow money commercially, paying back the commercial loan as quickly as possible. The cost of borrowing this more expensive money will be reflected in an increased purchase price of the homes. Using a special district to finance the infrastructure costs of a new development can therefore be seen as a loan to the new property owners who will have twenty years to pay off the cost of the improvements instead of having to pay it "up front."

A prospective property owner would be wise to ask some questions to determine future tax liability, such as:

- How much outstanding general obligation debt does the district(s) have?
- Are the principal and interest payments on the general obligation bonds insured? Are the bonds secured with a letter of credit?

- Are the bonds rated? If so, what rating have they received?
- If the bonds are Limited Tax Obligations, what is the mill levy cap associated with the bonds?
- Does the developer hold the bonds, or, have they been issued to the public?
- What is the amount of the yearly debt service payment?
- What revenue is being used to pay the debt service?
- If a property tax is assessed for debt service, is the revenue sufficient to pay the debt service, or does some other revenue supplement it?
- If there is another revenue source (such as a developer's contribution), how much of the total payment is it?
- If that supplemental source of revenue is removed, how much will taxes increase?
- What is build-out and how close to build-out is the district? Is there a schedule of construction? What is the actual construction compared to the plan?
- What is the ratio of debt outstanding to the assessed valuation of the district? (Debt greater than 20% of assessed valuation is considered a "red flag" to municipal bond people, although the district's specific circumstances must be evaluated in each case.)
- Has other debt been authorized but not issued? When will it be issued?
- Is there a "balloon" payment associated with the debt service in a future year?
- Has the district petitioned the federal bankruptcy court for adjustment of the debt? Is there is a court order approving a plan of adjustment of the debt? What does it state about the debt service and mill levy?

Many of these questions can be answered by contacting the Department of Local Affairs at 303-866-2156, or the districts directly, (whose telephone numbers are available from the Department).

SPECIAL DISTRICT RESIDENTIAL REAL ESTATE TRANSACTION DISCLOSURES

As mentioned above, a handful of special districts experienced financial difficulties in the mid/late 1980's and early 1990's, which caused some residential property tax bills to increase dramatically. In response to this problem, the state legislature passed a number of laws requiring certain disclosures to buyers of residential property, so that they would be aware that they were buying property that might be within a special district that can levy taxes and may have outstanding debt.

There are two such disclosures:

1. A purchase contract must include the language mandated by 38-35.7-101, C.R.S., which states

SPECIAL TAXING DISTRICTS MAY BE SUBJECT TO GENERAL OBLIGATION INDEBTEDNESS THAT IS PAID BY REVENUES PRODUCED FROM ANNUAL TAX LEVIES ON THE TAXABLE PROPERTY WITHIN SUCH DISTRICTS. PROPERTY OWNERS WITHIN SUCH DISTRICTS MAY BE PLACED AT RISK FOR INCREASED MILL LEVIES AND EXCESSIVE TAX BURDENS TO SUPPORT THE SERVICING OF SUCH DEBT WHERE CIRCUMSTANCES ARISE RESULTING IN THE INABILITY OF SUCH A DISTRICT TO DISCHARGE SUCH INDEBTEDNESS WITHOUT SUCH AN INCREASE IN MILL LEVIES. BUYER SHOULD INVESTIGATE THE DEBT FINANCING REQUIREMENTS OF THE AUTHORIZED GENERAL OBLIGATION INDEBTEDNESS, AND THE POTENTIAL FOR AN INCREASE IN SUCH MILL LEVIES.

2. At closing, the title agent/company must provide a statement disclosing pursuant to 10-11-122, C.R.S. that the subject property may be located within a special taxing district, a certificate of taxes due shall be obtained from the county treasurer, and information regarding special districts and their boundaries of may be obtained from the Board of County Commissioners, the County Clerk and Recorder, or the County Assessor.

Since the passage of these laws, the Department of Local Affairs has been supporting special districts, counties, realtors and residential property buyers by disseminating financial information about districts. Our experience has shown that the legal requirements are imperfect, and often lead to frustration for everyone. The Department is attempting to alleviate some of those frustrations by first, explaining what special districts are and what purpose they serve, and second, to give the real estate community the basic information it may need to help residential property buyers understand the special districts in which they may be buying real property.

The Department gets many telephone calls from prospective homebuyers, most of whom are not familiar with the various government agencies and their function. The first item the Department needs to help anyone learn about a district is the name of the district. This may sound simple, but it is a common source of frustration for homebuyers. They cannot call and simply give an address, expecting the state to know in which districts that address is situated. The only place they can learn this basic information is from the County Treasurer or County Assessor. Then, once they know the names of the districts the property is in, they may call the Department of Local Affairs for financial information on that set of special districts.

ISSUES TO CONSIDER WHEN ANALYZING A SPECIAL DISTRICT'S FINANCIAL CONDITION

We have identified some issues for consideration when a prospective homeowner is reviewing a special district's financial information. It is important to remember that every situation is unique and that an apparent financial problem in one district may or may not be significant when taken in context of that special district's development situation. Any area of concern should lead to further questioning of the district's representatives.

- **Year of Organization** - If a metropolitan district was organized in the mid-1980's, it is possible that the district's development was negatively affected by the downturn in Colorado's economy at that time. The infrastructure (roads, water, sewer, etc.) paid for by any debt issued may have been designed for development on a scale greater than the market could deliver. Such "development districts" which have not achieved the goal of their service plan can have trouble meeting their bond payment with the current mill levy. The age of the district can indicate how established and built out it is. Districts formed earlier, on the other hand, tend to be built out and not facing a speculative situation.
- **Current Level of Construction Compared to Planned "Build-out"** - This information is available from the special district. Knowing how near to completion the development is will help in estimating the tax burden per property. The cost of the infrastructure construction (for which the debt was issued) is apportioned per lot for repayment over a twenty-year period. When development is complete each property pays for its apportioned cost. Less than build-out means that the presently developed properties are responsible for more than their apportioned amount; they may be obligated to pay for the debt for infrastructure associated with the unsold or undeveloped properties.
- **Debt/Assessed Value Ratio** - This ratio shows a special district's ability to support debt based on the value of real property in the district. It is calculated by dividing the total outstanding general obligation debt by the total assessed value of the district. There is no percent figure which defines an absolute problem, but debt comprising more than 20% of the assessed value should prompt questions about the current rate of increase in the assessed valuation of the district since the district's organization. How many properties are being added to the tax roll each year?

- **Amount of Unissued Debt** - At the election to authorize indebtedness, questions were approved for the maximum funding necessary for the full development. Bonds may have been issued only for the amount of money needed at that time; for example, for the first phase of a multi-phase development. When the district issues additional bonds from the authorized debt, taxpayers may face increased payment obligations. (Under Colorado's TABOR amendment, it is unlikely that special districts will issue any debt approved prior to 1993 without submitting it for the current electors' approval.)
- **Debt Service/Operating and Debt Service Expenditures Ratio** - The debt repayment burden of a special district can be assessed by this ratio. A problem is often indicated when debt service payments comprise 15-20% or more of the combined operating and debt service expenditures. Questions must be asked about the district's ability to repay the debt. What is the size of the tax base? What other budget resources are available? What is the disposable income, or the median household income, of the special district residents?
- **Current Ratio** - This is a standard financial indicator used to evaluate whether or not a community is in a good position to pay those expenses due within the next year with reasonably assured assets such as cash and accounts receivable. Smaller, newer special districts, dependent almost exclusively on property tax, will often have weak current ratios. Questions should be asked about the nature and levels of the district's revenue sources.
- **Are Current Revenues from Operations and the Debt Levy Sufficient to Make Debt Service and Pay for Operations?** - A review of the special district's financial summary will show whether the district's revenue from its operations, its debt levy, and other revenue sources such as fund balance, are sufficient to make the debt service. If these revenues are not sufficient, where is the needed revenue coming from? Developers will sometimes make contributions to offset the shortfall in revenue. Questions should then be asked about how much longer will the contributions continue? When will the burden of the total debt obligation be placed on the property owners?

- **Debt Service Balloon Payments** - A balloon payment is a very large final payment for a greater number of bonds due than any preceding payment. If the debt service schedule shows such a payment due in several years the property owner knows that the tax requirement will increase correspondingly (if assessed value stays relatively constant). Balloon payments are usually refinanced; however, if the market/economic situation is not conducive to refinancing, the property owner may be at risk for a higher tax. The district can provide information on its debt management, including any plans to refinance.

SPECIAL DISTRICT FINANCIAL DATA BASE

The Special District Financial Data Base contains financial profiles of Colorado's metropolitan districts, water districts, sanitation districts, combined water and sanitation districts, park and recreation districts, hospital districts, and fire protection districts. The following types of information in the database are available for each special district:

- | | |
|--|----------------------------------|
| - Address and contact person | - Pertinent financial notes |
| - Revenues and expenditures | - Mill levy |
| - Current assets and liabilities | - Assessed valuation of district |
| - Total debt outstanding | - Services provided |
| - 5-year debt service repayment schedule | - County location. |

A sample, one-page financial profile from the Special District Financial Data Base is presented on the following page of this report.

The information contained in the database is summarized from the most recent special district audits submitted to the Colorado State Auditor. For more detailed information, the complete audited financial statements of each special district may be obtained from DOLA, which is located at 1313 Sherman Street, Room 521. If you have any questions regarding the Special District Financial Data Base, please call Don Merrion with DOLA at (303) 866-3001.

Big Dry Creek Metropolitan District
724 Eagle's Wing Drive
Castle Rock, CO 80104

Phone: 303-688-1234

2006

	Metropolitan			
<u>Revenues</u>	Fund	Water Fund	Sewer Find	TOTAL
Property Tax	\$2,455,236	\$0	\$0	\$2,455,236
Specific Ownership Tax	355,234	0	0	355,234
Charges for Services	0	851,246	822,897	1,674,143
Contributed Capital	2,576,105	611,112	599,021	3,786,238
Intergovernmental	15,568	0	0	15,568
Transfers In	0	160,000	0	160,000
Miscellaneous	400,555	175,588	157,652	733,795
Debt Proceeds	0	0	0	0
TOTAL	\$5,802,698	\$1,797,946	\$1,579,570	\$9,180,214
<u>Expenditures</u>				
Operating	\$2,001,120	\$340,457	\$341,555	\$2,683,132
Principal Payments	125,000	7,000	6,000	138,000
Interest Payments	1,250,000	5,000	5,250	1,260,250
Capital Outlay	0	244,154	245,012	489,166
Transfers Out	160,000	0	0	160,000
Miscellaneous	0	0	0	0
TOTAL	\$3,536,120	\$596,611	\$597,817	\$4,730,548
NET INCOME	\$2,266,578	\$1,201,335	\$981,753	\$4,449,666
<u>Debt Outstanding</u>				
General Obligation	\$24,250,000	\$0	\$0	\$24,250,000
Other	0	102,000	103,000	205,000
<u>Schedule:</u>				
2002	\$1,580,525	\$12,000	\$11,250	\$1,603,775
2003	1,700,000	12,000	11,250	1,723,250
2004	1,800,000	12,000	11,250	1,823,250
2005	1,750,000	12,000	11,250	1,773,250
2006	1,700,000	12,000	11,250	1,723,250
Authorized/Unissued Debt	\$75,000,000	\$0	\$0	\$75,000,000
<u>Balance Sheet</u>				
Cash/Investments	\$7,810,128	\$1,510,658	\$1,500,809	\$10,821,595
Current Assets	10,887,991	1,712,187	1,655,777	14,255,955
Current Liabilities	6,887,117	114,654	98,457	7,100,228
<u>Auxiliary Data</u>				
Population	Unknown			
Assessed Valuation	\$74,998,458			
Mill Levy: TOTAL	32.737 mills			
Operating	18.000 mills			
Debt	14.737 mills			
Year of Formation	1984			
Services Provided	Park & recreation; water; sanitation; street maintenance			
Location	Douglas County			
Notes: Bonds are insured. Bonds are Limited Tax Obligation Bonds, capped at 50 mills. Other debt outstanding consists of capital lease obligations.				